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No. 01-265

In The

Supreme Court of the United States

HOECHST CELANESE CORPORATION,

Petitioner,

v.

FRANCHISE TAX BOARD,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of The State Of California

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the nexus and fair apportionment requirements of the Due Process and Commerce Clauses of the United States Constitution allow a state to tax an apportioned share of surplus funds reverted to a multi-state company from its defined-benefit pension plan.

2. Whether there is any need to clarify the distinction between "operational" and "passive investment" as set forth in *Allied-Signal v. Dir., Div. of Taxation*, 504 U.S. 768.

3. Whether the California Supreme Court correctly interpreted and applied this Court's decision in *Allied-Signal, supra.*

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STATEMENT OF THE CASE

This case involves the taxation of surplus pension funds reverted to Hoechst Celanese Corporation ("Celanese") from its defined benefit pension fund. There is no issue as to whether taxation is proper. The contested issue has to do with whether the reverted surplus funds were properly apportioned, for tax purposes, among the various states in which Celanese did business, including California, or instead were required to be allocated entirely to New York, Celanese's commercial domicile.

The constitutional issue presented by this case is whether the asset, the pension fund, from which the surplus funds were derived, played an operational role in Celanese's multi-state business or served simply as a passive investment within the meaning of this Court's decision in *Allied-Signal v. Dir., Div. of Taxation*, 504 U.S. 768 (1992).

At the outset, Celanese attempts to portray the surplus funds in such a way that assumes the very conclusion it wishes to reach. For example, at page two of its petition, Celanese characterizes the issue as having to do with taxation of income "arising out of investment functions," and refers to the surplus funds as "investment gain" and as "pension reversion investment income." As is demonstrated by the trial court decision and the California Supreme Court's opinion, the asset from which the surplus funds were derived played an operational role, rather than serving as a passive investment, within the meaning of *Allied-Signal*. The fact that the pension plan and fund played an operational role is based not only on the evidence and the findings in this case; it is consistent with the characteristics of defined benefit pension plans

described in this Court's recent decision in *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999).

Allied-Signal focused on the relationship between the income-producing asset and the taxpayer's multi-state business in order to determine if the asset was a passive investment, the income from which is not apportionable, or operationally related to the multi-state business, in which case apportionment is appropriate. In this regard, the following conclusions of the California Supreme Court (which refers to Celanese as "Hoechst") are pertinent:

> "Hoechst created the income-producing property – the pension plan and trust – in order to retain its current employees and to attract new employees." (App. 39a.)[1]
>
> " . . . Hoechst regularly changed trustees and fund managers for various reasons, including inadequate performance, and even 'drastically altered' the plan's investment strategy in 1978. The surplus pension plan assets generated from this new investment strategy then allowed Hoechst to reduce or suspend its contributions to the plan otherwise required under ERISA. [citing this Court's decision in *Hughes Aircraft, supra*, 525 U.S. at p. 441.]" (App. 39a-40a.)
>
> "Because the pension plan assets contributed materially to Hoechst's production of business income via their effect on Hoechst's labor force, the 'acquisition, management and disposition of' these assets 'constitute integral parts of' Hoechst's 'business operations.' " (App. 40a.)
>
> "Here, the income-producing asset – the pension plan and trust – undoubtedly served an operational function for Hoechst. Hoechst

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[1] "App." refers to the appendix to the petition.

> funded the plan and trust with its apportionable business income. It managed the plan and trust by choosing the trustee and appointing a committee of its officers and employees to oversee the trust's administration, to choose its investment managers, and to guide its overall investment strategy. More importantly, Hoechst created and maintained the plan and trust in order to induce its current employees to stay and to attract new employees. As such, the pension plan and trust undoubtedly helped Hoechst 'make better use' of an important and existing business-related resource – its employees. [citing *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), at p. 178.] Indeed, Hoechst can hardly claim that the pension plan and trust were separable from its employee recruitment and retention efforts – a crucial part of its business operations in California. Accordingly, subjecting an apportionable share of the reverted pension plan assets to taxation in California does not violate the federal due process or commerce clause." (App. 44a-45a.)

Respondent Franchise Tax Board ("FTB") incorporates herein, by this reference, the statement of facts contained in the California Supreme Court's opinion. For the sake of clarity, the following elaborations are provided.

At page 7 of its petition, Celanese states that it reported the income as non-apportionable, non-business income on its California tax return. However, in its original tax return, Celanese reported the reverted surplus pension funds as apportionable business income. Celanese later filed an amended return reporting the income as non-business income. (RT 94:18-22.)

Also at page 7 of its petition, Celanese states: "Celanese reported the pension reversion *gain* as taxable

income on its 1985 corporation income tax returns for New York (and New York City) and paid tax on *that gain* to New York (and New York City)." (Pet. 7; emphasis added.) Thus, Celanese suggests that it paid tax in New York on all of the reverted surplus funds.

This suggestion is untrue. In fact, as shown on trial court Joint Exhibits 26 and 27, Celanese paid tax to New York on only a small, apportioned share of its income, including the reverted surplus pension funds. (See California Supreme Court's opinion, App. 6a; See, also, App. 41a, where the court notes that, absent apportionment, Celanese "would receive a windfall because New York – [Celanese's] commercial domicile – taxed only a small percentage of the reverted income.") Trial court Joint Exhibit 26 shows that Celanese paid tax to New York State on less than $17 million, representing less than 5 percent of its total income.

REASONS FOR DENYING PETITION

The petition for writ of certiorari should be denied. The decision of the California Supreme Court is perfectly consistent with this Court's precedents. Celanese, of course, contends to the contrary. However, it does so on the basis of a selective, incomplete, and non-contextual description of the California court's opinion. When all of the pertinent portions of the opinion are read, it will be seen that the California Supreme Court's opinion is expressly guided by constitutional concerns. No reasonable person reading the opinion will conclude that it is inconsistent with or conflicts with *Allied-Signal, ASARCO,*

Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982), or *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), all of which cases are cited substantively in the opinion.

As will be demonstrated herein, Celanese's petition is based on an analysis which is flawed. Among other things, it confuses the focus of the analysis in *Allied-Signal*, and overlooks the difference between the notion of "business," in the general sense, and "business income," a term of art recognized by this Court, which refers to the apportionable income of a multi-state business.

In addition to *Allied-Signal*, *ASARCO*, and *Container*, there is another decision of this Court which is important in the context of the instant case: *Hughes Aircraft Co. v. Jacobson, supra*. Although *Hughes Aircraft* did not involve the reversion of a pension fund, it addressed and explained the features of a defined benefit pension plan, and the relationship between pension fund earnings and company contributions to the fund. *Hughes Aircraft* dispelled many misconceptions regarding defined benefit pension plans and provides a clear basis for understanding the impact operation of such a plan has on the operations of a business. Given this Court's decisions in *Allied-Signal*, *ASARCO*, *Container*, and *Hughes Aircraft*, there is nothing that this Court needs to say on the subject contained in the instant case.

Moreover, there is no basis to grant the petition on the basis of some alleged body of judicial and administrative cases which reflect inconsistent interpretations and applications of *Allied-Signal*. Although Celanese alleges in several parts of its petition that such a body of cases

exists, it has failed to cite a single such case. Of course, FTB cannot respond to cases not cited in the petition.

In addition to the foregoing, Celanese cannot meet its burden to show "by clear and cogent evidence" that taxation by California constituted the taxation of extraterritorial values. (*Container*, 463 U.S. at 164, quoting from earlier decisions; *Allied-Signal*, 504 U.S. 768, 782.) The pension plan and pension fund in the instant case were part of the compensation of Celanese's employees, without whom Celanese could not have engaged in its multistate business. Celanese administered the plan. Celanese appointed the trustee. Celanese appointed the managers who invested the pension funds. The fund managers followed the pension fund investment strategy imposed on them by Celanese. Pension fund earnings reduced Celanese's labor costs as a result of reducing its pension costs, and thus increased its apportionable income. Consequently, it cannot reasonably be denied that the plan and fund were "related to" Celanese's multi-state business and served an "operational function" within the meaning of *Allied-Signal*.

It follows that the instant case does not present a suitable subject for this Court's consideration.

I. THE CALIFORNIA SUPREME COURT PROPERLY INTERPRETED AND APPLIED THIS COURT'S PRECEDENTS

A review of all of the California Supreme Court's opinion, and not just the portions cited by Celanese in its petition, shows that the California Supreme Court was guided in its analysis of the instant case by this Court's

precedents in the area of apportionment, including *ASARCO*, *Container*, and *Allied-Signal*. As a consequence, the California Supreme Court opinion is in harmony with this Court's interpretation and application of the pertinent constitutional provisions, and it is not necessary for this Court to grant the petition. Celanese's petition is based on distortions and misinterpretations of the California Supreme Court opinion and of the decisions of this Court, as well as of the facts of this case, as determined by the trial court and confirmed by the California Supreme Court.

A. The California Supreme Court's Opinion Properly Applies *Allied-Signal*

Celanese's petition is based on the notion that the California Supreme Court's opinion is inconsistent with *Allied-Signal*. However, as will be demonstrated, the inconsistency is between Celanese's interpretation of *Allied-Signal* and the *Allied-Signal* decision. Celanese contends, in effect, that the reversion of surplus pension funds, which it refers to as the "pension reversion gain" (Pet., p. 22), was not related to its multi-state business operations (Pet., pp. 22-23). Thus, it poses as a significant factor the existence or non-existence of a relationship between the "gain" or proceeds derived from an asset and a taxpayer's multi-state business.

Celanese also contends that a transaction (i.e., the reversion) which it alleges was a "once-in-a-corporate-lifetime event" cannot satisfy *Allied-Signal*'s operational standard (Pet., p. 23). (See, also, page 21 of the petition:

"What could be less 'operational' than this pension reversion gain which resulted from a once-in-a-corporate-lifetime event;. . . . ") Thus, Celanese also poses as a significant factor the frequency of an event, or its relative rārity, by which income is derived from an asset.

Given these contentions, it is worth noting what *Allied-Signal does* say and what it does *not* say. *Allied-Signal* does say that there must be some relationship between an income-producing *asset* and a company's multi-state business in order for a state in which that multi-state business is done to be able constitutionally to tax a share of the income derived from that asset. (*Allied-Signal,* 504 U.S. at 785: The relevant inquiry is "one which focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities with the taxing State.")

However, *Allied-Signal* does not look to the frequency of the type of transaction which gives rise to the income or proceeds, nor does it concern itself with the relationship between those proceeds and the taxpayer's multi-state business. *Allied-Signal* looks squarely at the relationship between the *asset* from which the income is derived and the multi-state business.

Thus, Celanese's focus on the relationship between the "gain" or the "reversion" (i.e., the act by which the surplus funds were transferred from the pension fund) and the company's multi-state business is misplaced. No such relationship is relevant under *Allied-Signal.* Likewise, Celanese's repeated allegations that the reversion of

surplus pension funds was a "once-in-a-corporate-lifetime event" are irrelevant.[2]

Not only does the petition misapply *Allied-Signal* by focusing on the wrong relationship, it distorts the California Supreme Court's opinion along the same lines. In an effort to fit the California Supreme Court opinion into a Procrustean bed, Celanese states that the California Supreme Court "took the position the *gain* was operational. . . . " (Pet., p. 21, emphasis added.) However, no such statement is made in the California Supreme Court opinion. The California Supreme Court did not say that the *gain* was "operational." What the California Supreme Court said was that "the *income-producing asset* – the pension plan and trust – undoubtedly served an operational function for Hoechst [Celanese]." (App. 44a; emphasis added.)

In concluding that the asset (the pension fund) was operationally related to Celanese's multi-state business, the California Supreme Court noted the relationship between the pension plan and fund and the maintenance

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[2] Celanese states that "[i]t is *undisputed* the pension reversion was a rare, once-in-a-corporate lifetime event for Celanese. . . . " (Pet. 20; emphasis added.) This statement is false. Throughout this litigation FTB has, in fact, disputed the statement that the reversion was a "once-in-a-corporate lifetime event," most recently in its reply brief before the California Supreme Court, p. 4. Although the phrase was used by the trial court and the California Supreme Court, the statement is not supported factually by the record nor does it express an existing legal principle. However, as pointed out in the text, the frequency of the event is irrelevant for purposes of constitutional analysis.

of Celanese's work force and thus, unlike Celanese, engaged in a proper analysis. This case does not present an appropriate vehicle for further discussion of *Allied-Signal*'s distinction between "operational" and "passive investment." Review of the California Supreme Court's opinion is not warranted.

B. The California Supreme Court Properly Relied on *Container*

The California Supreme Court's opinion includes language from this Court's opinion in *Container* in which it was stated that "an asset serves an operational function if it helps the taxpayer 'make better use . . . of [its] existing business-related resources.' [citation]." (App. 44a, quoting from *Container, supra,* 463 U.S. at p. 178.) Celanese contends that the California Supreme Court's use of this language is flawed because the language "has *nothing* whatsoever to do with the 'operational' issue presented in *Allied-Signal*." (Pet. 16; original emphasis.) This contention should be rejected.

Celanese overlooks the fact that while *Container* and *Allied-Signal* deal with superficially different situations, both cases are based on the same notion, which is that the propriety of apportionment of income depends on the relationship between the activity or asset giving rise to the income and the taxpayer's business. In *Container*, the question was expressed in terms of the relationship between the taxpayer's business and a different but commonly owned company. In *Allied-Signal*, the question was expressed in terms of the relationship between an asset of the taxpayer and the taxpayer's multi-state business.

Container and *Allied-Signal* are not "apples and oranges," as Celanese seems to suggest. (Pet. 11.) They are fruit of the same tree, a tree firmly rooted in the underlying principle that what matters ultimately is the relationship between the taxpayer's multi-state business and the source of the income under consideration.

Indeed, the very standard articulated in *Allied-Signal* upon which Celanese claims it relies (i.e., "serves an operational rather than an investment function"), is derived from the unitary business analysis of *Container*. *Allied-Signal*, 504 U.S. 768 at 788. Moreover, in *Allied-Signal* this Court applied the unitary test of *Container* (functional integration, centralization of management, and economies of scale) to resolve the apportionable business income issue presented in *Allied-Signal*. (*Id.*, at 789.) Thus, the business income and unitary business tests are ones of common origin.[3]

C. The California Supreme Court's Reference to "Making Better Use" is Consistent With *Allied-Signal* and *ASARCO*

The California Supreme Court described the relationship between the pension plan and trust and Celanese's multi-state business in terms of the fact that the plan and

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[3] Just as *Allied-Signal* drew upon *Container*, *Container* anticipated the *Allied-Signal* situation as manifested in the following passage: "[t]here must be some sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a *passive investment or a distinct business operation*. . . . " (*Container*, 463 U.S. 159, 166; emphasis added.)

trust helped Celanese "make better use" of Celanese's employees. Although this language is drawn from *Container*, it is consistent with *Allied-Signal*. As noted above, *Container* and *Allied-Signal* are based on the same principles.

Celanese, however, grounds its petition on the idea that the "make better use" language somehow creates an interpretation or standard which conflicts with *Allied-Signal* because it goes too far. Celanese's argument is based on the notion that the "making better use" language is identical to the "business purpose" standard rejected by this Court in *ASARCO* and *Allied-Signal* (Pet. 14). In so contending, Celanese is confusing two different concepts involving the word "business." The California Supreme Court's references to making better use of an important business-related resource and contributing to the production of "business income" are different from the "business purpose" standard as understood by this Court in *ASARCO*.

In *ASARCO*, this Court understood the reference to "contributing to the taxpayer's *business*" as including any income received by a corporate entity. (*ASARCO*, 458 U.S. 307, 326.) However, when the California Supreme Court refers to business *income*, it is referring to "business income" in the context of the statute which it was interpreting. In other words, it is referring to apportionable income, or income of the multi-state business.[4] This Court

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[4] Cal. Rev. & Tax. Code sec. 25120 defines and distinguishes between "business income" and "non-business income." Section 25128 of the same code provides for apportionment of "business income" pursuant to a formula. Thus, "business

recognized that "business income" is a term of art which refers to the apportionable income of a multi-state business. (*Allied-Signal*, at 786.)

The California Supreme Court's reference to "making better use" serves as an explanation of the connection between the pension plan and fund, on the one hand, and Celanese's work force, which was needed in order for Celanese to engage in its multi-state business, on the other. It is a statement which looks towards the production of "business [i.e., apportionable] income." It is a statement akin to those issued by this Court, such as the statement in *Container* to the effect that there must be a "minimal connection" between the taxing state and the interstate activities (*Container*, 463 U.S. 159, 165-166) or that there must exist "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." (*Container*, at 166, quoting from an earlier case.)

The reference to "making better use" of a business-related asset reasonably is to be understood in the context of the California Supreme Court's statement, earlier in its opinion, to the effect that income from property is apportionable business income "if the taxpayer's acquisition, control and use of the [income-producing] property contribute materially to the taxpayer's production of *business income*." (App. 33a; emphasis added.) Thus, the court is speaking of an asset which is related to the multi-state, or apportionable, business of the taxpayer.

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income" and "apportionable income" or "multi-state income" are synonyms.

The phrase "contributing to the taxpayer's *business*" as used in *ASARCO* is a generalized statement which refers to anything that benefits the taxpayer. The phrase "contributing materially to the production of *business income*" describes concretely an operational relationship between an asset and a company's multi-state business.

It is illuminating to apply this distinction to the facts in *Allied-Signal*. In the case of *Allied-Signal*, the proceeds from the sale of the stock contributed to the "business" of the taxpayer as would the proceeds from any of its corporate activities, but the stock sale proceeds were not apportionable, multi-state "business income."

D. When All Pertinent Portions of the California Supreme Court's Opinion Are Considered, Including Those Portions Ignored by Celanese's Petition, It Is Obvious That The Opinion Is Consistent With *Allied-Signal*

In stating that the language from *Container* regarding "making better use" was "the only language looked to by the California Supreme Court on the 'operational' issue" (Pet. 16), and in stating that the California Supreme Court addressed "the constitutional issues in less than three pages of its forty-page majority decision" (Pet. 8-9), Celanese reveals that it is ignoring an essential part of the California court's constitutional analysis. The "less than three pages" reference refers to Section II of the opinion (App. 43a-45a). Thus, Celanese focuses attention on only the last portion of the California Supreme Court opinion, and fails to recognize the earlier, constitutionally related

discussion contained in that portion of the opinion which deals with the meaning of "integral."

In its discussion of the meaning of the word "integral," as that word is used in the business income definition, the California Supreme Court expressly cited this Court's opinion in *ASARCO*. (App. 31a.) In addition, a substantial portion of the court's discussion of the meaning of "integral" referred to other judicial and administrative cases which have examined the relationship between the income-producing property and the taxpayer's business, an examination which is the same as that called for in *Allied-Signal*. (App. 32a-40a.) None of these portions of the California Supreme Court's opinion are discussed by Celanese in its Petition.

In considering what is meant by "integral," the California Supreme Court was guided by a desire to avoid an interpretation of the word which would result in unconstitutional taxation. The California Supreme Court was presented by the parties with two interpretations. Celanese contended that "integral" means "necessary and essential," whereas FTB contended that "integral" refers to an asset which depends upon or contributes to the taxpayer's multi-state business.

The California Supreme Court rejected both interpretations. It stated that Celanese's standard was too restrictive (i.e., it would not include some income which ought to be apportioned), while it stated that FTB's interpretation was too broad, and might run afoul of constitutional limitations. With regard to FTB's definition of "integral," the California Supreme Court stated that "[c]onstruing 'integral' as 'contributing to' makes the test

too expansive and *creates constitutional problems*. Although property that is integral to a taxpayer's business undoubtedly contributes to that business, 'integral' *must imply something more than a mere contribution*. Otherwise, the functional test would encompass all corporate transactions and run afoul of the constitutional limits on state taxation. [citing *ASARCO*.]" (App. 31a; emphasis added.) It concluded that the correct interpretation was somewhere in between the two interpretations proposed by the parties. (App. 32a.)

Thus, in rejecting FTB's definition of "integral," and in concluding that the correct interpretation of "integral" falls "somewhere in between these two interpretations," the California Supreme Court defined "integral" in a manner which it considered to be more restrictive than that proposed by FTB, which the court expressly considered to require more than "a mere contribution," and which was to be expressly understood in the context of *ASARCO*. That this is so is made clear by the California Supreme Court's interpretation of "integral" to refer to an

> " 'organic unity' between the income-producing property and the taxpayer's business activities. [citation] The property must be so interwoven into the fabric of the taxpayer's business operations that it becomes 'indivisible' or inseparable from the taxpayer's business activities with both 'giving value' to each other. [citation] Such a relationship exists when the taxpayer controls and uses the property to contribute materially to the taxpayer's production of business [i.e., apportionable] income. [citations]" (App. 33a.)

The California Supreme Court's description of income-producing property, which is, for example, "interwoven into the fabric of the taxpayer's business operations," defines a category of property which is in complete harmony with this Court's operational function standard as set forth in *Allied-Signal*. When a particular asset is "organically unified" with the taxpayer's business activities, when it can be said to be a part of the fabric of the taxpayer's business operations, then it follows that it does not constitute a mere passive investment, but rather that it is operationally related and connected to the multi-state business.

Although the California Supreme Court's discussion of "integral" related initially to the court's interpretation of the business income definition, that discussion forms an essential part of the context within which what the court said about the constitutional issue must be understood. Indeed, the court's discussion of the meaning of "integral" was expressly guided by constitutional concerns, as is evident in that portion of the opinion in which *ASARCO* is cited. That discussion forms an essential part of its discussion of the constitutional issues.

For the reasons set forth above, Celanese's contentions, regarding the California Supreme Court's interpretation and application of this Court's precedents, are based on misinterpretations of those precedents and of the California Supreme Court's opinion. In fact, the California Supreme Court's opinion is entirely consistent with this Court's precedents, a conclusion which any reasonable, objective reader will reach. This Court's review of that opinion is not necessary.

II. THE REVERTED SURPLUS PENSION FUNDS WERE PROPERLY TAXED ON AN APPORTIONED BASIS BY CALIFORNIA

In addition to contending that the language of the California Supreme Court's opinion is defective, Celanese also contends that the court erred in concluding that California's taxation of an apportioned share of the reverted surplus pension funds is consistent with *Allied-Signal*. This contention is not reasonable and should be rejected.

During the relevant time period, Celanese employed approximately 29,000 persons. (App. 78a.) Without those employees it could not have engaged in its multi-state business. Celanese was obliged to compensate those employees. The compensatory system by which a company induces its employees to work for it is a central feature of the operations of any company which relies on employees. The pension plan and fund are key elements of that compensatory system. Thus, the pension plan and fund were operationally related to Celanese's multi-state business operations.

In addition, earnings from the pension fund served to reduce Celanese's ongoing labor costs. This occurred because of the relationship between contributions and pension fund earnings, a relationship lucidly explained by this Court in its decision in *Hughes Aircraft*.

As this Court pointed out in *Hughes Aircraft*, earnings or losses in a defined benefit pension fund do not affect the benefits owed or paid to plan participants. (*Hughes Aircraft*, 525 U.S. at 440-441.) They do, however, affect the amount the company must contribute, and thus directly

affect the company's labor costs. Every dollar of pension fund earnings reduces the company's labor costs. When the plan is qualified under ERISA, the amount of reduction is enhanced because the pension fund earnings are exempt from taxation. Companies thus have an incentive to qualify their plans under ERISA.

It should also be noted that when a company realizes lower labor costs as a result of pension fund earnings which reduce its contribution costs, the result is a net increase in its taxable business income. The reason this occurs is that pension fund contributions are deducted from apportionable business income. When those contributions are decreased as a result of pension fund earnings, the company's apportionable business income increases.[5]

What occurred in the instant case is that Celanese chose to benefit from the surplus through the act of reversion rather than using the surplus to decrease its contributions. An increase in income due to a reversion of surplus pension funds is conceptually no different than an increase in net apportionable business income which is due to a reduction of pension fund contributions made possible by a surplus in the pension fund. There is no logical basis to distinguish between them for purposes of

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[5] The trial court made the following finding: "For all years Celanese filed California franchise tax returns, its contributions to the plan were deducted in full as ordinary and necessary business expenses in computing Celanese's income subject to tax in California." (App. 80a; See, also, App. 44a.) Thus, a decrease in contributions resulted in an increase in apportionable income subject to tax in California.

taxation. In either case, the water is drawn from the same well.

Celanese had not only the motive to want healthy pension fund earnings, it had the opportunity to do something about it. It is beyond reasonable dispute, as demonstrated by the record, as found by the trial court, and as confirmed by the California Supreme Court, that the pension fund managers were selected by Celanese, and that they made their pension fund management decisions within the framework of a pension fund investment strategy devised by Celanese.

This Court has pointed out that "[i]t remains the case that, '[i]n order to exclude certain income from the apportionment formula, the company must prove that "the income was earned in the course of activities unrelated to [those carried out in the taxing] State." ' [quoting from earlier decisions]." *Allied-Signal*, 504 U.S. 768, 787. Based on the foregoing, it is clear that Celanese has no hope of meeting this burden.

III. CELANESE HAS FAILED TO ESTABLISH THAT THERE EXISTS A BODY OF CASES WHICH ARE INCONSISTENT WITH *ALLIED-SIGNAL*

Celanese suggests that there are numerous cases which inconsistently interpret and apply *Allied-Signal*'s operational standard. At page 23 of its petition, Celanese states that "[j]urisdictions will continue to inconsistently interpret and apply *Allied-Signal* . . . ."

Celanese has failed to cite a single case evidencing any "continuing inconsistent interpretations." The only

cases which Celanese does cite are either out-of-date or inapposite. FTB cannot respond to cases which are not cited in the petition.

At page 24 of its brief, Celanese cites two cases decided in 1979. These two cases pre-date not only *Allied-Signal* but *Container* and *ASARCO*, as well. They certainly do not serve as illustrations of a current series of cases which "continue to interpret *Allied-Signal* inconsistently."

Celanese also cites the North Carolina Supreme Court's decision in *Union Carbide v. Offerman*, 526 S.E.2d 167 (N.C. 2000). It does so in several portions of its brief, including portions in which it argues that the California Supreme Court opinion misinterprets *Allied-Signal*. However, *Union Carbide* dealt only with a statutory interpretation of North Carolina's business income definition, which, like California's, is patterned after Section 1 of the Uniform Division of Income for Tax Purposes Act, and reached an interpretation with which the California Supreme Court disagreed. (The interpretation of the statutory definition of "business income" is not an issue before this Court.) The North Carolina court saw no need to address the constitutional issue once it interpreted the statute in the taxpayer's favor.

It is interesting to note that *Union Carbide*, which was decided in 2000 but which fails to make any reference to *Hughes Aircraft*, demonstrates a fundamental misunderstanding of the difference between defined *benefit* and defined *contribution* pension plans. It does so when it states that pension plan funds in a defined benefit plan "functioned as an investment for the benefit of Union Carbide employees." (*Union Carbide*, 526 S.E.2d at 171.)

The statement would be true if applied to a defined *contribution* pension plan, but is completely wrong when applied to a defined *benefit* plan, for reasons set forth with great clarity in *Hughes Aircraft*, an opinion evidently not considered by the North Carolina court.

This confusion is not only of academic interest. The relationship between the earnings of a defined benefit pension plan and the sponsoring company is direct and significant, as described elsewhere in this brief, as set forth clearly in *Hughes Aircraft* and cases which follow it, and as recognized in the California Supreme Court decision in the instant case. (App. 39a-40a.) A defined benefit plan not only serves as part of the compensatory mechanism which helps any company to conduct its business, but the earnings of the pension fund reduce the company's labor costs and thus increase its net taxable income. If the company, like Celanese, is engaged in a multi-state business, the reduction in labor costs results in an increase in apportionable net income.

(To the extent Celanese attempts to cite *Union Carbide* as somehow supporting its constitutional argument, it is worth noting a feature of that opinion which the California Supreme Court gave as one of its reasons for declining to follow it: "*Union Carbide* appeared to focus on the surplus rather than the income-producing property – the pension plan assets." (App. 42a.) See Section I, Part A, of this brief, above.)

Celanese has failed to demonstrate the existence of any conflict or inconsistency which warrants this Court's attention.

IV. THE CALIFORNIA SUPREME COURT'S DECISION DOES NOT UNDERMINE CONSTITUTIONAL RESTRAINTS ON STATE TAXATION

Celanese's contention, that the opinion below will "undermine constitutional restraints on state taxation" (Pet. 26) is, once again, the product of a selective misreading of the California Supreme Court's decision. It should therefore be rejected summarily.

The California Supreme Court's opinion directs FTB not to apply what it refers to as the "functional test" portion of the statutory business income definition unless the income-producing asset is part of the fabric of a taxpayer's multi-state business, or "organically unified with it." As a consequence, there can be no reasonable doubt that the California Supreme Court's decision presents at least as stringent an obstacle to apportionment for tax purposes as does *Allied-Signal*. FTB submits that it is not likely that a reasonable person who reads the entire opinion of the California Supreme Court will think otherwise. Review by this Court of the California Supreme Court's decision would serve no useful purpose.

CONCLUSION

For the reasons set forth above, the petition for writ of certiorari should be denied.

Respectfully submitted,

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